



LAW ANSWERED

SAMPLE CHAPTER FROM OUR DEBT FINANCE ELECTIVE GUIDE

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LOANS

KEY LOAN PROVISIONS

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The clauses below refer to those provided by the Loan Market Association in its standardised multicurrency revolving facility agreement for investment-grade borrowers.

PURPOSE CLAUSE (LMA 3)

This restricts the Borrower to ensure that the funds are used for the agreed purposes only.

An obvious violation puts the Borrower in default and means that the Borrower holds the loan monies on resulting trust in favour of the Bank (*Barclays Bank v Quistclose*) – this is an advantage on insolvency because the monies will not be part of the borrower's assets to be split up in the order of priority.

NOTE: if the purpose clause appears restrictive, it is worth amending it to be broader, so that it is stated to be “for general corporate purposes”.

CONDITIONS PRECEDENT (“CP”) (LMA 4 & SCHEDULE 2)

“Conditions Precedent to the first utilisation” includes any documents which ensure that all legal matters are in place before the Bank is obliged to lend, e.g.:

- The Obligors’ constitutional documents;
- Any board minutes of the Obligors approving the terms and authorising a signatory;
- Specimen signatures of the signatory;
- The legal opinion; and
- Duly executed copies of the Finance Documents.

Further Conditions Precedent: that the Repeating Representations can be made, and that in the case of the first loan **no actual or potential** event of default (“**Default**”) is continuing, or in the case of a rollover loan, that that there is **no actual event of default** (“**Event of Default**” or “**EoD**”).

Lender’s obligation to make advances only arises on satisfaction of the CPs – but note that certain fees will accrue from the signing of the loan agreement, even if CPs are not met.

It is therefore important if acting for the Borrower to check:

- Are the CPs as clear and objective as possible so that the Borrower knows exactly what is needed to satisfy them?
- Are any time limits feasible?
- Is approval required or discretion allowed?
- If the Borrower will rely on any 3rd parties, what control can be exercised over them?

If there is an issue, the lender should make it a CP, e.g. if large loans require member approval, make it a CP that the Borrower gets this resolution.

Other examples of CPs:

- Prior planning permission for any construction works the loan is intended for;
- Seeing the management accounts;
- Confirming the borrower has all compulsory insurance in place, e.g. Employer's Liability Insurance and possibly taking out insurance to cover unexpected losses for the project the loan is funding;
- Obtaining waiver letters (if there is an existing loan with a negative pledge); and
- Amendment of Articles (if directors have the right to refuse a share transfer).

INTEREST

The agreement will specify the interest rate applicable for the duration of the loan, how it will be calculated and how it will be added to any outstanding balance. This may be set out as either:

1:	<p>Floating Rate (LMA 9) = aggregate of:</p> <p>a) Reference rate (previously LIBOR but may now include rates such as the Bank of England Bank Rate, SONIA or SOFR) (Bank's cost of funds) – fixed at the first day of each Interest Period until the start of the next one when a new rate applies;</p> <p>b) Margin (Bank's profit margin) – usually fixed for the term; and</p>
2:	Fixed Rate which will not change throughout the loan term.
3:	Variable Rate – according to a schedule, e.g. 10% for the first year, 9% for the second, 8% for the third, etc.
4:	<p>Default Interest – The agreement may assert that higher interest is due on the event of non-payment.</p> <p>NOTE: the Bank must have a commercial interest in setting such a rate and this clause must not be deemed to be a penalty. A punitive rate of interest will be struck out (<i>Cavendish v Makdessi</i>; <i>ParkingEye v Beavis</i>) – an additional 2 to 3% should be acceptable, but above 5% starts to look questionable.</p>

GOVERNING LAW AND JURISDICTION & SERVICE OF PROCESS (LMA 39 & 40)

- English law applies to the interpretation of the **LMA** in the event of a dispute.
- If security is taken over foreign assets, then security will always be granted under the relevant local law (*lex loci*) in case English law is not upheld when it comes to enforcement.
- If the Borrower is incorporated outside England a Process Agent will be appointed to accept service of proceedings on its behalf.
- Arbitration clauses are common for project finance funding.
- If the Borrower is a state-entity it will waive its immunity from proceedings.

REPRESENTATIONS

REPRESENTATIONS

These are statements of fact or present intention made by the Obligors on the day of signing and generally repeated or deemed to be repeated at certain points during the term of the loan.

Purpose:

- to elicit information from the Obligors; and
- to provide for “**drawstop**” (the right by the Lender to refuse to make further loan advances) or for the bank to call a default if there is a misrepresentation.

Representations also provide a contractual remedy in the event that they are false at the time they are made, as this would trigger a misrepresentation event of default (**LMA 23.4**).

Usually deemed to be **repeated** on the date of each drawdown request, and on the first day of each interest period.

- A **separate disclosure letter** could be used in which the borrower discloses against the above warranties and representations. This is generally not done because the disclosure letter will only be effective when the representations are first given – it will not be effective when the representations are repeated.
- Most facilities require the representations and warranties to be given on execution, and to be repeated immediately prior to each utilisation and on the first day of each interest period. An officer of the Borrower could provide a **certificate** which would repeat the representations – or the documentation could simply state that the representations are “deemed” to be repeated on certain dates.

EXAMPLES OF REPRESENTATIONS

- Status of Borrower – duly incorporated
- Borrower has the power to enter into the finance documents
- Obligations under the finance documents are valid and binding
- No Event of Default is continuing
- Accounts are properly prepared and there has been no MAC since the date of their preparation

It is common for the bank to ask for a “*catch all*” representation, such as that there is “*nothing that the Borrower has omitted to tell the Lender, that if the Borrower had told the Lender, the Lenders would not be willing to lend in respect of.*”

The Borrower should beware of making a **misrepresentation** (a representation which is untrue). Misrepresentation can be fraudulent, negligent or innocent – but in any event the Bank would have a right to rescission (if practically possible and not barred) or damages (**Smith New Court v Scrimgeour Vickers**).

LENDER'S POSITION

- Representations **reduce the risk** for the Bank as they force the Borrower to disclose information and any changes to its position. They also give the lender **control**; misrepresentation is an event of default, and an inability to repeat the representations as required under **LMA 4.2(b)** will trigger a drawstop (meaning a borrower will be unable to draw any further funds).

BORROWER'S POSITION

- The Borrower will want as few representations repeated as possible, whilst the Bank will want as many as it can get. The Borrower could try to argue that a representation is only relevant at completion, is unlikely to change, or is covered by an undertaking already – but these are all weak arguments.
- A solicitor acting for the Borrower should not allow the representation that there is no **potential event of default** to be repeated, as an inability to repeat this will itself be an actual event of default.
- Do not make **unqualified** and **uncontrollable** statements (e.g. the borrow will face no litigation whatsoever during the loan term). A simple immaterial inaccuracy can come to constitute a misrepresentation.
- Representations should only be made by the **Obligors and any Material Subsidiaries** of the Borrower.
- Borrower will want a **knowledge qualifier** (*"to the best of my knowledge"*) at the start of any representation, but the Bank is not likely to accept this. Bank might accept specific *"carve-outs"* concerning things it already knows about the Borrower. Also be mindful of what type of knowledge is included. Does it include actual, constructive and imputed knowledge of the borrower?

UNDERTAKINGS

UNDERTAKINGS

Promises by the Borrower to the lender to do, or not do, something. Undertakings are different from representations as they apply continuously, whereas representations only apply at the moment of their making.

The purpose of undertakings is to allow the Bank to monitor the Borrower's performance and its compliance with the loan covenants on an ongoing basis.

There are three categories of undertaking:

1:

Information Undertakings (LMA 20) – Examples:

- To send financial statements within x days.
- To supply any information requested by the Agent.
- To notify of any actual or potential default – usually the Facility Agent should be notified, depending on the terms of the Facility Agreement.
- To comply with the bank's Know Your Customer (**"KYC"**) checks. Banks are obliged to carry out KYC checks to identify the true identity of their clients and the source of their funds. This involves the Borrower providing information to the Bank.
- For both the lender and borrower to meet confidentiality requirements.

2:	<p>General Undertakings (LMA 22) – Examples:</p> <ul style="list-style-type: none"> • To comply with all laws. • Negative Pledge – not to grant any Security or Quasi-Security to any other party. • No financial indebtedness – the Borrower will not incur additional financial indebtedness (loans and other types of debt). • No disposals other than Permitted Disposals or capital expenditure. • No change of business. • To insure assets and keep them in good repair.
3:	<p>Financial Covenants: promises by the Borrower to meet certain financial targets, which will differ by industry and Borrower. Generally used as an early warning indicator for the Bank. Any of the following example measures could be set to a minimum level to which the Borrower must adhere:</p> <ul style="list-style-type: none"> • Minimum Net Worth • Working Capital (which is the ratio of current assets to current liabilities) • Gearing (which is the ratio of a firm's debt to its equity) • Interest Cover (which is generally measured through “PBIT” (Profits Before Interest and Tax) or “EBITDA” (Earnings Before Interest, Tax, Depreciation and Amortisation).

LENDER'S POSITION

- Undertakings give the Bank (and Agent) **control** over how the Borrower runs its business, and allow the Bank to **monitor** it through receiving regular information.
- Breach of an undertaking also allows the bank to call an event of default.
- The Bank should think carefully about the levels at which it will set any Financial Covenants in order to balance being able to respond early enough to a worsening situation and turnaround the Borrower's financial position, with not being constantly notified of inconsequential breaches.

NOTE: the Bank should beware of becoming too involved in the running of a company and becoming a shadow director. The repercussions of taking on the duties and liabilities of a director are especially significant in an insolvency situation.

BORROWER'S POSITION

- Compliance with undertakings is a time-consuming administrative burden.
- To lessen this burden, the Borrower will want any undertakings to be realistic and consistent across all its other loans – for example, if the limit for a Permitted Disposal is the same across all the Borrower's facilities, the Borrower can carry on its business without checking through all of its different loan agreements every time it wishes to make a disposal.
- The Borrower will want to limit the undertakings to include **Material Subsidiaries** only.
- The Borrower will not want Financial Covenants to be breached when it is not in financial difficulties, as this will interfere with the running of its business.